

Louisiana Law Review

Volume 35 | Number 4

Writing Requirements and the Parol Evidence Rule: A

Student Symposium

Summer 1975

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Repository Citation

Bruce Achille Gaudin, *Legal Expenses and the Origin Test*, 35 La. L. Rev. (1975)

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risk encountered by the plaintiff to be beyond the duty imposed on the defendant.

More importantly, the instant decision demonstrates a tendency by the lower courts to extract from *Dixie* and *Pierre* a "rule" out of what was originally meant to be an approach or technique.³³ Prior to the introduction of the duty-risk approach, courts had, by applying the "passive negligence" doctrine as a rule, generally relieved the original wrongdoer from liability.³⁴ Disapproval of the "passive negligence" rule was not intended to establish a converse rule sustaining a finding of liability against the original wrongdoer regardless of the nature of the subsequent misconduct of a third party.³⁵ Nevertheless, in applying the holding in *Pierre* to the factual situation before it, the court in the present case appears to have substituted a rule automatically sustaining the liability of the original wrongdoer for one automatically rejecting liability.³⁶ Duty-risk should be viewed as a method of analysis that leaves the courts free to consider the acts of misconduct in the context of the facts and circumstances of each controversy and to confer immunity upon the original wrongdoer where policy so dictates. The current confusion exemplified by *Shaw* suggests a need by the lower courts to pause and take note of the true nature of the duty-risk approach so that the effort of the supreme court to infuse flexibility into Louisiana tort law will not be frustrated.

Sylvia R. Cooks

LEGAL EXPENSES AND THE ORIGIN TEST

Taxpayers, sole shareholders of a corporation, received the cor-

33. See *Addison v. Travelers Ins. Co.*, 281 So. 2d 805, 812 (La. App. 1st Cir. 1973); *Phillips v. Ursin*, 280 So. 2d 243, 249 (La. App. 4th Cir. 1973); *Craig v. Burch*, 228 So. 2d 723, 729 (La. App. 1st Cir. 1969); *Pico v. Allstate Ins. Co.*, 206 So. 2d 99, 101 (La. App. 4th Cir. 1968).

34. See cases cited at note 2, *supra*.

35. *Ruminations* at 393.

36. Referring to *Pierre*, Professor Robertson observed: "What the case amounts to is a clear and almost fully explicit admonition that rules are not magic; that each case must be approached, within a fabric of principle and doctrine, on its own facts. It seems evident that the Supreme Court of Louisiana has been trending rather strongly in recent years toward a fairly consistent position that the Louisiana tort law should seek to avoid the proliferation of doctrines of narrow and rigid thrust, in favor of more straightforward, conscious, and fact-oriented resort to the underlying principles of the Louisiana Civil Code." *Dialogues* at 24-25. See also *Ruminations* at 369.

porate assets upon liquidation, including a potential anti-trust claim¹ which had no ascertainable market value at the time of distribution.² The taxpayers treated the legal expenses subsequently incurred by them in settling the claim as deductible expenses for the maintenance and conservation of property.³ Reversing the Tax Court's allowance of the deduction,⁴ the Fifth Circuit Court of Appeals held that the deductibility of legal expenses ultimately depends on the origin of the legal claim and thus classified the taxpayers' expenses as non-deductible capital expenditures.⁵ *Estate of Meade v. Commissioner*, 489 F.2d 161 (5th Cir.) cert. denied, 419 U.S. 882 (1974).

Legal expenses are susceptible of three tax results. Those expenses incurred in connection with purely personal activities which have no profit-seeking motive are non-deductible under section 262 of the Internal Revenue Code and may not be capitalized. Expenses which are "ordinary and necessary" (1) to carry on a trade or business (section 162), or (2) for the production or collection of income, for the management of income-producing property, or in connection with determining tax liability (section 212) may be deducted currently. Finally, section 263 requires capitalization rather than current deduction of any profit-seeking expenditure which is capital in nature rather than "ordinary and necessary."⁶

In classifying legal expenses, the Commissioner and the courts early focused attention on the taxpayer's motive or purpose for incurring the expense in question. In the often-cited case of *Rassenfoss v. Commissioner*,⁷ the Seventh Circuit Court of Appeals determined that a partner was entitled to currently deduct legal expenses incurred in defending an action by a superintendent of the partnership who claimed an interest in the business and sought an accounting

1. See Clayton Anti-Trust Act, 15 U.S.C. § 15 (1914).

2. For the implications of such an "open transaction," see *Burnet v. Logan*, 283 U.S. 404 (1931); *Dennis v. Commissioner*, 473 F.2d 274 (5th Cir. 1973).

3. INT. REV. CODE OF 1954, § 212.

4. *Estate of Joseph M. Meade v. Commissioner*, 31 CCH Tax Ct. Mem. 935 (1972).

5. Capitalization rather than current deduction resulted in an additional tax amounting to \$29,991.37 for Mr. and Mrs. Meade and \$65,221.26 for Mr. and Mrs. King, the taxpayers in the instant case. Since the expenses were deemed capital in nature they could only be used to offset the capital gain realized by the taxpayers from the settlement and could not be deducted from ordinary income.

6. Examples of capital expenditures can be found in the Treas. Reg. § 1.263(a)-2(a)-(h) (1960). INT. REV. CODE OF 1954, § 263 limits deductions otherwise allowed by sections 212 and 162. See *id.* § 261. See also *id.* § 1221 for the definition of "capital asset."

7. 158 F.2d 764 (7th Cir. 1946).

from the partners. To justify the allowance, the court reasoned that "the main and primary purpose of the suit which petitioner defended was for an accounting and any question of title was merely incidental thereto."⁸ Although difficult to apply because of its subjective nature, the "primary purpose" test was followed by a substantial number of lower courts in order to separate deductible expenses under sections 212 and 162 from section 263 capital expenditures.⁹

The "origin of the claim" test was first clearly enunciated in *United States v. Gilmore*¹⁰ to differentiate between section 262 personal expenses and section 212 deductible expenses. Refusing to accept taxpayer's argument that certain legal expenses incurred in defending a divorce action were deductible under section 212, the Court held that:

[T]he origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense . . . is deductible or not. . . .¹¹

Three years later, the Supreme Court used the origin test to distinguish between deductible section 162 business expenses and non-deductible section 262 personal expenses.¹²

A major extension of the origin test came in the landmark decisions of *Woodward v. Commissioner*¹³ and *United States v. Hilton Hotels Corp.*¹⁴ For the first time, the Supreme Court applied the origin test in the area of section 263 capital expenditures. Both cases involved legal expenses incurred to comply with local laws requiring

8. *Id.* at 767.

9. For a brief list of cases, see Gibbs, *Developing Patterns in the Deductibility of Professional Fees*, 50 TAXES 771, 775 (1972).

10. 372 U.S. 39 (1963). While the origin of the claim test was clearly stated for the first time by *Gilmore*, similar reasoning was employed in earlier cases. See *Deputy v. du Pont*, 308 U.S. 488 (1940); *Kornhauser v. United States*, 276 U.S. 145 (1928).

11. 372 U.S. at 49. In *Gilmore*, taxpayer alleged that if he lost the divorce litigation he would lose the bulk of his personal property from which he derived the major part of his income. The Supreme Court held that none of the expenses of resisting his wife's claims could be considered deductible business expenses.

12. *Commissioner v. Tellier*, 383 U.S. 687 (1966). The Court accepted the taxpayer's claim that legal expenses incurred by him in unsuccessfully defending a criminal prosecution should be deductible under section 162. "The criminal charges against the respondent found their source in his business activities as a securities dealer. The respondent's legal fees, paid in defense against those charges, therefore clearly qualify under *Gilmore* as 'expenses paid or incurred . . . in carrying on any trade or business' within the meaning of § 162(a)." *Id.* at 689.

13. 397 U.S. 572 (1970).

14. 397 U.S. 580 (1970).

majority stockholders to purchase the stock held by minority stockholders who dissented to proposed corporate actions.¹⁵ There was no question that the payments for the stock itself should be treated as capital investments;¹⁶ the contested issue was the proper treatment of the expenses of negotiating the fair price of the stock.¹⁷ The taxpayers urged that the "primary purpose" test should be applied and that the legal expenses of valuation should be deductible as ordinary and necessary expenses.¹⁸ They claimed that the transfer of the capital asset was merely incidental to their main purpose of fixing the price.

Pointing out that the primary purpose test was too subjective and would encourage "resort to formalisms and artificial distinctions,"¹⁹ the Court rejected taxpayers' arguments and held that the primary purpose test does not apply to cases involving the disposition or acquisition of title to a capital asset.²⁰ Employing the origin of the claim test of *Gilmore*, the Court then traced the origin of the expenses to the acquisition of the stock and ruled the valuation only incidental thereto. The decisions provoked some criticism,²¹ but on the whole their rationale was received with approval and applied without hesi-

15. The corporate action in *Hilton Hotels* was a merger; the action in *Woodward* was a perpetual extension of the corporate charter. Under the New York law applicable in *Hilton Hotels*, title to the stock passed to the taxpayers as soon as the minority registered their dissent. In *Woodward*, passage of title was delayed under Iowa law until after the price was set in the appraisal proceeding. To the Supreme Court, this was merely "a distinction without a difference." 397 U.S. at 584.

16. See Treas. Reg. § 1.263(a)-2 (1960): "The following . . . include examples of capital expenditures: (a) The cost of acquisition . . . of . . . property having a useful life substantially beyond the taxable year."

17. Although this note is concerned primarily with the tax treatment of legal expenses, the law is not so limited. Cost of acquisition or disposition of property should properly include accountant's fees and brokerage costs as well as attorney's fees. See *Woodward v. Commissioner*, 397 U.S. 572, 577 (1970).

18. In *Hilton Hotels*, the taxpaying stockholder, a corporation, claimed the expenses to be "ordinary and necessary" to its business under section 162. The taxpaying stockholders in *Woodward* were acting in an individual non-business capacity. They claimed their expenses to be "ordinary and necessary" under section 212.

19. 397 U.S. at 577.

20. Both *Woodward* and *Hilton Hotels* dealt with the acquisition of a capital asset. For a case in which the legal expenses of a disposition were required to be capitalized by reducing the amount realized, see *Third Nat'l Bank v. United States*, 427 F.2d 343 (6th Cir. 1970).

21. See Gibbs, *supra* note 9 at 777, where it is suggested that the taxpayers' claims may have originated in connection with the conservation of their stock within the deductions allowed by section 212(2). See also Comment, 70 COLUM. L. REV. 538, 543 (1970), which contends that the origin test as applied in *Woodward* related deductibility to the capacity of the litigating taxpayer. The comment suggests that the expense would have been deductible if the plaintiffs had acted in a business rather than an individual capacity.

tation by the lower courts.²²

Difficulties may arise, however, when the parties have already agreed to transfer a capital asset and legal expenses are subsequently incurred in enforcing the transfer. Two appellate court decisions held that such expenses are not part of the cost of the transfer and can be deducted from ordinary income. In *Naylor v. Commissioner*,²³ legal expenses were incurred in negotiations to determine and collect the book value of stock that the taxpayers had sold when the purchaser exercised his option to buy. The Fifth Circuit held the expenses to be ordinary and necessary for the collection of income under what is now section 212(1).²⁴ In *Commissioner v. Doering*,²⁵ the taxpayer was given a pro rata portion of a claim against a third party in exchange for his stock at liquidation. As in *Naylor*, the Second Circuit chose not to treat the expenses of prosecuting the claim as section 263 capital expenditures, but allowed the deductions under section 212.²⁶

The instant case offered the Fifth Circuit an opportunity to re-examine the deductions allowed in *Naylor* and *Doering* in light of the origin test as applied in *Woodward* and *Hilton Hotels*. The taxpayers in *Meade* attempted to bring their expenses within the deductions expressly allowed by section 212, advancing the reasoning accepted in *Naylor* and *Doering*.²⁷ The Tax Court allowed the deduction as expenses for the collection of income, expressly refusing to abandon the rationale of *Doering*.²⁸ The Fifth Circuit, although admitting that *Naylor* and *Doering* presented problems similar to the instant case,²⁹ distinguished the two prior decisions by noting that in *Meade* the anti-trust claim was only a claim and not an enforceable right, whereas in *Naylor* and *Doering* the legal expenses were incurred to enforce contracts that were already fully negotiated and signed.³⁰

22. *Third Nat'l Bank v. United States*, 427 F.2d 343 (6th Cir. 1970), *Helgerson v. United States*, 426 F.2d 1293 (8th Cir. 1970) (attorney's fees originating in the process of disposition of stock were capital expenditures). See also *Ransburg v. United States*, 440 F.2d 1140 (10th Cir. 1971) (legal expenses for interpretation of buy and sell agreement having their origin in the acquisition and disposition of stock were neither ordinary nor necessary); *Great Lakes Pipeline Co. v. United States*, 352 F. Supp. 1159 (W.D. Mo. 1972) (expenses not deductible as incidental to section 337 liquidation, but were part of the sale of capital assets).

23. 203 F.2d 346 (5th Cir. 1953).

24. See Int. Rev. Code of 1939, § 23(a)(2).

25. 335 F.2d 738 (2d Cir. 1964).

26. *Id.* at 741.

27. *Estate of Meade v. Commissioner*, 489 F.2d 161, 167 (5th Cir. 1974).

28. 31 CCH Tax Ct. Mem. 935, 937 (1972).

29. 489 F.2d at 167.

30. *Naylor v. Commissioner*, 203 F.2d 346, 347 (5th Cir. 1953); *Commissioner v. Doering*, 39 T. C. 647, 650 (1963).

The *Meade* court, however, failed to explain why the distinction should dictate different tax treatment. Since the origin test is concerned only with whether a particular claim has its origin in a capital transaction, the claim's enforceability would seem irrelevant to establishing deductibility. The origin of the claim, not the present enforceability of the claim, should be the controlling factor. Despite the court's reluctance to expressly disavow the earlier cases, the fact that they were distinguished is a signal to potential litigants that the origin test will be applied in the future. Indeed, the Fifth Circuit cautioned against placing undue reliance on the prior decisions.³¹

The particular facts in *Meade* leave room for further speculation. The possibility of filing a civil anti-trust suit was first contemplated by the corporation within the ordinary course of its business. The liquidation forced the taxpayers to prosecute the claim to final settlement in their capacity as individual shareholders. Under these facts, the expenses were held to be of a capital nature and part of the cost of the stock. But had the corporation itself litigated the claim to its conclusion, every indication points toward allowing the deduction under section 162³² since the origin of the claim then would have arisen from the "ordinary and necessary" business of the corporation.³³ Thus, the origin of the claim may change, depending on the capacity of the person litigating it.

At the trial level, the Tax Court specifically rejected such a conclusion, stating that the "origin" does not mean "how the claim was acquired," but rather "the event which gave rise to the claim."³⁴ Since the cost of the event (the anti-trust suit) would have been deductible to the corporation, the Tax Court reasoned that it should be deductible for the shareholders. In reversing the Tax Court's decision, the Fifth Circuit followed a formula that is basic to the tax structure. Deductibility is not determined solely by scrutinizing an isolated event; the courts look to the character or nature of the claim as related to the capacity of the taxpayer. While the origin test as applied in *Meade* may not have eliminated all of the "uncertainties"

31. "We think that the *Naylor* and *Doering* decisions have been considerably eroded by *Woodward* and *Hilton Hotels*. . . ." 489 F.2d at 167.

32. See 31 CCH Tax Ct. Mem. 935, 937 (1972), where the Commissioner "admits that if the corporations had received the \$900,000, it would constitute [ordinary] income" and legal expenses would not be capitalized.

33. There is one possible exception. If the corporation had prosecuted the claim in anticipation of liquidation, the expense would not be ordinary under section 162 and it would be necessary to capitalize the attorney's fees. See *Of Course, Inc. v. Commissioner*, 499 F.2d 754 (4th Cir. 1974), *overruling* *Pridemark, Inc. v. Commissioner*, 345 F.2d 35 (4th Cir. 1965).

34. 31 CCH Tax Ct. Mem. at 938.

and "formalisms" of the primary purpose test it was designed to replace, the subjective motives of the taxpayer are no longer controlling. Thus, the origin test should lead to more consistent results.

Bruce Achille Gaudin

FUTURE INFLATION AND DAMAGE AWARDS

Although money damages awarded in a tort action cannot make the victim whole again, the award provides the only means available to compensate the plaintiff for his injury and to place him in a position roughly equivalent to that which he enjoyed before the accident.¹ In arriving at a figure that will theoretically reimburse the victim for his loss, various factors must be considered.² One important component often ignored in calculating the amount of damages is the possibility that inflation may occur in the future. At the outset it should be noted, however, that the only portion of the plaintiff's award that may be affected by inflation is the sum given for some future economic deprivation, such as loss of future wages or future medical expenses; future economic developments are irrelevant to items such as pain and suffering or past medical expenses which represent losses that have already accrued at the time of judgment.

The need to adjust damage amounts to allow for future inflation is sharpened by the impact of the technique, termed reducing to "present value," often used by the courts to calculate future damages. An award for loss of future wages should exactly compensate the victim for what he would have received had he not been injured; it should not place him in a better monetary position than he would have enjoyed had he received his future salary in periodic payments.³ If the victim is *presently* given the total dollar amount of damages that the fact-finder has determined he is entitled to, he has been over-compensated to the extent of the "earning power" of the sum he receives.⁴ A sum of money available at present is worth more than an

1. See *Chesapeake & Ohio Ry. Co. v. Kelly*, 241 U.S. 485, 489 (1916).

2. *United States v. Boykin*, 49 F.2d 762 (5th Cir. 1931) (present value of lump sum award); *Gaspard v. Le Maire*, 245 La. 239, 158 So. 2d 149 (1963) (effects of past and present inflation); *Brown v. S.A. Bourg & Sons, Inc.*, 239 La. 473, 118 So. 2d 891 (1960) (victim's life expectancy); *Edwards v. Sims*, 294 So. 2d 611 (La. App. 4th Cir. 1974) (probability of future job promotion).

3. *Chesapeake & Ohio Ry. Co. v. Kelly*, 241 U.S. 485, 489 (1916).

4. "So far as a verdict is based upon the deprivation of future benefits, it will afford more than compensation if it be made up by aggregating the benefits without taking account of the earning power of the money that is presently to be awarded. It is self-evident that a given sum of money in hand is worth more than the like sum of money payable in the future." *Id.*